EXHIBIT 5
DATE 1-8-09
HB organizational meeting

History of Agricultural Land Taxation in Montana

As of July 1, 1973, the Department of Revenue was delegated the responsibility for classifying all agricultural lands. Previously, that was the duty of the county commissioners under Chapter 191, Laws of 1957. As with the previous law, the values determined by the department were to be based on the productive capacity of the land, i.e., the ability of the land to produce income from a cash crop (wheat, hay, forage for grazing, etc.).

Standardized agricultural land valuation schedules were developed in the early 1960s. The standardized values were based on a capitalization of net operating income (gross income less operating expenses), using data from the USDA Crop and Livestock Reporting Service, Montana Department of Agriculture Statistics, the Farm Services Administration, and other government agencies.

The department updated and revised the agricultural land valuation schedules for the reappraisal cycle that concluded on December 31, 1985. Again, the primary source of the data was the various government agencies listed above. A concerted effort was made to include individual operations and agriculturally related associations to help refine the figures.

After developing the new valuation schedules, public comment was solicited through the administrative rule process. Agriculturalists expressed their lack of support of the new valuation schedules because the new schedules would have increased the valuation of some types of agricultural land. To address their concerns, former Governor Ted Schwinden suspended the rules hearing process. Governor Schwinden directed the department to assemble an advisory committee to review the data and procedures and to make changes, if necessary.

The advisory committee had difficulty arriving at a consensus on the agricultural land valuation schedules. The 1985 Legislature froze the agricultural land valuation schedules that were in effect, specified the approach for developing future agricultural land valuation schedules, and required the formation of an agricultural advisory committee.

In September 1990, the Department of Revenue Agricultural Advisory Committee was appointed by Governor Stephens. The committee reviewed, evaluated, and recommended changes to the valuation and taxation of agricultural land. It presented its recommendations at public meetings held throughout the state. The recommendations of the committee were passed by the 1993 Legislature in Senate Bill 168. SB168 required specific methodology, formula, and data sources in the calculation of the new agricultural land valuation schedules. While the appraised value of agricultural land increased significantly, the statewide impact of the new schedules on taxable value was neutral. There were shifts in value, however, within the various classes of agricultural land (i.e. grazing, non-irrigated farm land, continuously cropped hay land, non-irrigated continuously cropped farm land, and tillable irrigated land). The tax rate for agricultural land was reduced from 30% to 3.86%. That was the same tax rate used for residential and commercial property.

To mitigate the impact on agricultural taxpayers, the bill provided a phase-in of the change in taxable values over a four-year period. Both increases and decreases in value were phased in over the four year period. Finally, Senate Bill 168 established another interim agricultural land advisory committee to review water costs and other issues applicable to the valuation and assessment of agricultural land. That committee was appointed in November 1993. Committee recommendations adopted by the 1995 Legislature in Senate Bill 198 included:

- allowing a base water cost of $ 5.50 per irrigated acre;
- establishing an energy cost base year for irrigated land;
- limiting allowable water costs to a maximum of $35 per acre of irrigated land; and
- continuing the phase-in of the taxable value of agricultural land.

In May 1996, Governor Racicot appointed the next agricultural land valuation advisory committee as required by law. The committee reaffirmed the specific methodology, formula, and data source requirements in current law; updated those requirements using current data; and recommended new agricultural land valuation schedules to the department. In accordance with the provisions of SB184, passed by the 1999 Legislature, the new schedules were phased-in. For those agricultural land types that had a decrease in valuation, the decrease was realized immediately. For agricultural land that had an increase in valuation, the increase is phased-in over a four-year period beginning in 1999.

In May 2001, the fourth agricultural land valuation committee, appointed by Governor Martz, met to evaluate and propose valuation schedules. The Committee recommended valuation schedules were to be implemented January 1, 2003 and would remain in effect until December 31, 2008. Due to the phase-in of property values, the 2003 agricultural valuation schedules will not be fully implemented until 2008. Any decrease in land valuation was fully implemented in 2003. The values will not change from 2004 through 2008.

In 2001, the legislature passed HB609. This bill allowed current and future agricultural advisory Committees' greater flexibility to recommend methodology changes through administrative rule rather than requesting the changes directly through the legislature. The 2001 - 2002 agricultural advisory committee chose to exercise this option in several areas as they made their final recommendations.

The committee recommended that the productivity range midpoint for continuously cropped hay land grade H1 change from 3.0 to 3.2 tons per acre.

The committee recommended six methodology changes in the valuation of irrigated land.

1. Elimination of irrigated rotations.
2. Increasing the base water cost from $5.50 to $10.00 per acre.
3. Changing the alternative minimum value for irrigated land from summer fallow land to 0.9 tons production of continuously cropped hay land.
4. Reducing the water cost categories from seven to five.
5. Eliminating the two lowest irrigated production grades.
6. Changing the midpoint for the production range that represents irrigated grade I-6 to 0.9 tons per acre.

The committee recommended the creation of an interim committee that is composed of representatives from agricultural organizations in the state to study the irrigated land valuation system and the implementation of the irrigated land valuation system.

The committee endorsed a change to administrative rule 42.20.147 that further defined agricultural eligibility for landowners who produce and raise livestock. It is:

1. The land must produce and the taxpayer must market, not less than $1,500 in annual gross agricultural income.
2. That converts to the land's carrying capacity having to support not less than 30 animal unit months per year (AUM's/year).
3. Senate Bill 549 was passed by the 2007 Legislature. SB549 codified the Committee's recommendation for establishing a minimum carrying capacity for grazing land. The Department of Economics and Agricultural Economics at Montana State University will determine the minimum carrying capacity that, if capable, would allow the land to produce to the minimum income requirements provided in law.

Although not a Committee recommendation, other laws passed by the 2007 Legislative Session impacted the classification of certain agricultural lands. Those laws include Senate Bill 316 which allowed agricultural classification to continue for parcels of land that were reduced to less than 20 acres in size when lands were taken or dedicated to a public use. This law only impacted lands

that were classified as agricultural land prior to the reduction in acreage. House Bill 3 (HB3) was passed during the May 2007 Special Legislative Session and HB3 allows a property tax exemption for lands impacted electrical transmission lines of a certain size. The exemption extends for 660' in each direction from the centerline of the transmission line.

In 2006, Governor Schweitzer appointed the 5th Agricultural Land Valuation Advisory Committee. Once again the Committee reaffirmed the specific methodology, formula, and data source requirements in current law. The Committee recommended that the Department develop a geographic information system (GIS) for capturing and storing agricultural land use information. Classification of agricultural land would be developed using a combination of recent color aerial photography, on site field reviews, informal discussions with local agricultural landowners and focus group discussions with agricultural producers in the state. Productivity information would come from the Natural Resource Conservation Service (NRCS) soil surveys. Parcel ownership boundaries would be identified using information stored on the state cadastral website. The information contained in the GIS would be used to generate maps in late 2008 and the maps would be mailed to each individual landowner for verification of the information.

To assist the Department in developing the GIS, the Committee made recommendations that would allow better use of the NRCS soil survey information.

Agricultural Valuation

Valuation Formula for Agricultural Land
(MCA 15-7-201)
The formula for valuation of agricultural land is:
V= I/R
Where:
V – is the value of each type of agricultural land.
I – is the net income of each type of agricultural land.
R – is the capitalization rate. That rate converts the net income estimate into an estimate of productive value

The box shows an example of how the capitalization rate is applied to the income of agricultural land to get a productive value per acre. If the capitalization rate decreases, the productive value and property tax on the land increases. If the capitalization rate increases, the productive value and property tax on the land decreases.

Income per acre = $50
Capitalization rate = 6.4%
Value = $781.25 per acre ($50) / 6.4% = $781.25 per acre

Classification of Agricultural Land

Approximately 50 million privately owned acres are classified as agricultural land in Montana. Classification is the determination of the agricultural use and the productive capability of that use for each acre of taxable agricultural land.

The criteria for classifying property as agricultural are:

- Parcels of land 160 acres or more under one ownership are classified and taxed as agricultural land. These lands are taxed at 3.01% in tax year 2008. The land cannot be devoted to a commercial or residential use and must not have covenants or other restrictions that prohibit its use as agricultural land.

- Parcels of land containing 20 acres or more but less than 160 acres under one ownership are classified and taxed as agricultural land if the land is used primarily for raising and marketing agricultural products. The agricultural use test presumes the land is agricultural if $1,500 in annual gross income is produced and marketed from the land by the owner, owner's immediate family, agent, employee or lessee. The tax rate for these parcels is 3.01%. If the land does not qualify based on its own production merits, SB296 (2005 Legislature) allows the owner of these parcels to use the relationship with a family member or family farming/ranching entity to qualify the parcel as agricultural land. The land must be devoted to an agricultural use, and it must be used in conjunction with the rest of the family farming/ranching entity. The land must be within 15 air-miles of the family operated entity and the owner or family entity must prove that at least 51% of their Montana gross income comes from agricultural activities.
- Parcels of land containing at least 20 acres but less than 160 acres, that do not qualify under these criteria are considered non-qualified agricultural land. These non-qualifying parcels are valued as average (Grade 3) grazing land. The taxable value of the non-qualifying land is computed by multiplying that value by seven times the tax rate for agricultural land. Because the current rate for agricultural land is 3.01%, the tax rate for non-qualified agricultural land is 21.07%
- Parcels of land less than 20 acres under one ownership are taxed as agricultural land if the land produces and the owner markets $1,500 in annual gross income from the raising of livestock, poultry, field crops, fruit, or other animal or vegetable matter for food or fiber. If the land does not meet the income requirement, it is valued as Class 4 tract land.
- Land is not valued as agricultural if it is subdivided with stated restrictions prohibiting its use for agricultural purposes. The land may not be devoted to a residential, commercial, or industrial purpose.

Agricultural Classes of Land

Grazing Land
Grazing land includes native range or domestic range lands that are used to support agricultural livestock. Grazing land is graded on the basis of the soil's capacity to produce palatable forage for livestock without causing injurious effect to the vegetative cover of the land. Carrying capacity is measured in Animal Unit Months per acre (AUM/AC) or acres per Animal Unit Month AC/AUM). Grazing land that is irrigated a majority of the time and has a reliable source of water is classified as irrigated land. Dryland alfalfa or grazing land, which is not irrigated or hayed a majority of the time, is classified as grazing land.

Tillable Irrigated Land
Tillable irrigated land includes all hayland and cropland that is irrigated a majority of the time (two out of three years, three out of five years, etc.). All agricultural land, including grazing land, in a specified irrigation district where the land is designated as irrigable with shares of water appurtenant to such land is classified as irrigated, regardless of whether the water is actually applied to the land.

Land with water for irrigation most years is classified as irrigated if the water is used. Those lands with water available most years, but the water is not used, are classified according to current use.

Land that is irrigated only during high water may be classified according to use, but it should carry a higher grade to reflect the occasional extra water and increased production.

Irrigated land schedules are based on tons of alfalfa per acre. Alfalfa is the predominant crop grown on irrigated fields. Adjustments can be made for other cash crops using a conversion guide.

Continuously Cropped Non-Irrigated Hayland
Continuously cropped non-irrigated hayland is characterized by native vegetation, non-irrigated

alfalfa, or other domestic varieties of hay cut yearly or a majority of the time over a period of years. Hayland that is irrigated less than a majority of the time or that does not have a reliable source of water is classified as continuously cropped non-irrigated hayland. It carries a higher grade to reflect the occasional irrigation.

Non-Irrigated Farmland: Summer Fallow Land Continuously Cropped
This is the typical dryland farming found in the majority of Montana. Strip farming or "block farming" are the most common forms of nonirrigated farmland.

Summer fallow: Typically, crops are produced every other year or every third year and the land is left idle in the off years.

Continuously cropped lands: The lands are found primarily in northwestern Montana. Normally, crops are grown three out of four years, and it must be an accepted practice for the area. Grading is based on bushels of wheat per acre. Conversions are made for barley production.